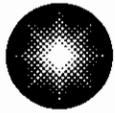


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Constellation Energy

June 28, 2005

VIA OVERNIGHT MAIL

The Honorable James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Harrisburg, Pennsylvania 17105-3265

Re: Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. § 2807(e)(2), Docket No. L-00040169.

Dear Secretary McNulty:

Enclosed please find the Reply Comments of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (collectively, "Constellation"). Constellation respectfully requests that you accept these comments one day out-of-time. Please feel free to contact me with any questions.

Kindly date stamp and return the extra copy in the enclosed self-addressed stamped envelope.

Respectfully Submitted,

Lisa M. Decker/EAK

Lisa M. Decker
Counsel

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Rulemaking Re Electric Distribution Companies'
Obligation to Serve Retail Customers at the
Conclusion of the Transition Period Pursuant
To 66 Pa. C.S. §2807(e)(2)

Docket No. L-00040169

**REPLY COMMENTS OF
CONSTELLATION ENERGY COMMODITIES GROUP, INC. AND
CONSTELLATION NEWENERGY, INC.
ON PROPOSED REGULATIONS FOR
PROVIDER OF LAST RESORT SERVICE IN THE
COMMONWEALTH OF PENNSYLVANIA**

Dated: June 28, 2005

I. INTRODUCTION

The importance of the Proposed Rulemaking Order issued by the Pennsylvania Public Service Commission (“Commission”) in the public register on February 26, 2005 is underscored by the many filings that the Commission has received on the proposed regulations (“Regulations”). Many of the filings express strong general support for Regulations, as did Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc (collectively, “Constellation”) in their filing *Comments of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. on Proposed Regulations for the Provider of Last Resort Service in the Commonwealth of Pennsylvania*, filed with the Commission on April 27, 2005 (“Constellation Comments”). While the Constellation Comments proposed several modifications and clarifications to the Regulations (that Constellation urges the Commission to adopt), Constellation continues to believe that the Regulations overall achieve a well-balanced approach to defining the obligations of the Electric Distribution Companies (“EDCs”) (also referred to in the regulations as the default service provider (“DSP”)) to provide default service, referred to as provider of last resort (“POLR”) service, while at the same time ensuring the continued development of competitive retail markets.

Several parties that submitted comments on the Regulations, however, would have the Commission reform the Regulations in ways that might infringe on the development of well-designed default service. The comments submitted herein by Constellation (“Constellation Reply Comments”) are designed to address those comments and urge the Commission to reject proposals (i) that compromise the development of effective retail competition or (ii) that would abandon or lessen the effectiveness and efficiency of the wholesale competitive procurement process envisioned by the Regulations.

II. CONSTELLATION REPLY COMMENTS

A. Final regulations should require implementation of wholesale competitive procurement processes.

For wise and prudent reasons, the Commission has proposed the use of a wholesale competitive process to serve the default service needs of the Commonwealth’s customers. As

described further below, several commenters have proposed changing the proposed rules and moving to a retail default service model. Constellation submits that the wholesale model is appropriate for this time and this stage of development of competitive markets in Pennsylvania. The wholesale model and the rules the Commission has proposed to implement it strike a fair and equitable balance between various market segments and most importantly provide benefits to customers. Therefore, Constellation urges the Commission to continue to support the wholesale model at this time.

Direct Energy Services, LLC (“Direct Energy”) and Reliant Energy, Inc. (“Reliant”) take issue with Chapter 54.31 of the Regulations that establishes the EDC as the default or POLR service provider. Reliant’s proposed alternative, the Market Responsive Pricing Model (“MRPM”), claims that “the small business/residential customer proposal contained in the Rule relies too heavily on an administrative determination and could result in the default price becoming below market for too long a period of time.”¹ Reliant’s MRPM, however, does not appear to be an improvement over the proposed Regulations. For instance, under Reliant’s MRPM, the Commission would “establish an initial commodity price that recognizes the inherent risks of providing default service.”² Subsequent to establishing this initial price, the default service provider could seek adjustment to that price two to three times per year. The initial price would be set by any number of methodologies, including direct provision of the service by the utility or its affiliate, by establishing a discount to the utility rate in effect at the end of transition period, or conducting a one time competitive solicitation in which EGS bid to provide the default service.

Thus, there is no commitment in the MRPM to ensuring the residential and small commercial customers, for whom *retail* competitive service is currently limited, would receive any benefits of the *wholesale* competition inherent in the proposed Regulations. Rather, under the MRPM, these customers would be subject to fluctuating rates that would most likely only increase, given that the default provider would have the discretion to determine when and if it seeks changes to the initial price. Because Reliant’s MRPM is likely, ultimately, to lead to a high default service price for residential and small commercial customers, Reliant is likely correct when it claims that its proposal will promote the development of retail competition as

¹ See Comments of Reliant Energy, Inc. on Proposed Rulemaking Order, dated April 27, 2005, Docket No. L-00040169, at p. 12 (“Reliant Comments”).

² *Id.* at p. 10.

more customers will be incented to switch due to the higher prices. But the Commission should question whether such a proposal appropriately balances the goal of promoting retail competition with the goal of providing residential and small commercial customers - for whom the shopping alternatives are limited - a measure of stability in their electric prices.

Direct Energy's proposal for a Retail Default Service Model would similarly have the Commission put the existence of retail competition ahead of other important considerations, such as the fact that residential and small commercial customers in all jurisdictions have shown little interest in shopping, and that, in most jurisdictions, few competitive retail suppliers are available to serve these customers. It is also unclear how Direct Energy's proposal would enhance retail competition. While it is true that the EGSs that successfully bid to become the default service provider³ will be successful retail competitors, it is not clear how this promotes additional retail competition any differently than implementation of a wholesale competitive procurement process as it would simply replace the EDC as the default provider with the EGSs that happen to secure the contract to become the default provider. Furthermore, Direct Energy's proposals would require the EDCs to continue providing backstop service to the retail bid that Direct Energy supports. Specifically, Direct Energy proposes that "Retail customers would have an "opt out" option, in which case the opting-out customers would take the EDC's monthly priced "default" service."⁴ Direct Energy fails to specify how the EDCs would secure the monthly priced default service for the customers that opt out of its Retail Default Service, but presumably that service would require the EDC to enter into contracts with wholesale entities. Thus, the need for a competitive procurement by the EDCs remains under Direct Energy's proposals, as does a requirement that the EDCs maintain all their customer service functions. Therefore, it is unclear how customers would achieve tangible savings under the Direct Energy proposals given that the EDC retains the ultimate obligation to serve, the costs of which must be included with the retail supplier's costs of providing POLR retail service.⁵

³ Constellation notes that while Direct Energy refers to the EGS as the default service provider, the EDCs must, under their proposal, remain prepared to offer monthly fixed price service to anyone who opts out of the EGS service.

⁴ See Comments of Direct Energy Service, LLC, dated April 27, 2005, Docket No.L-00040169, at p. 7 ("Direct Energy Comments").

⁵ Direct Energy also advises the Commission that if its retail default service model is not adopted, residential and small commercial customers should receive only monthly fixed priced service. Constellation disagrees with Direct Energy's view that these customers would be better served by monthly fixed priced service.

The National Energy Marketers Association (“NEMA”) proposed in its comments that the Commission establish a date certain by which the EDC’s should exit the merchant function.⁶ NEMA contends that the Electric Choice Act’s preference for competitive markets over regulation requires that EDCs exit the merchant function.⁷ However, there is nothing in the Electric Choice Act that mandates elimination of the EDC as the POLR provider, the provision of which, in any event, is arguably not a merchant function in the first instance, and the Commission has prudently chosen to take a deliberate and careful approach to determining whether and when the EDCs could or should exit the POLR function. Thus, Constellation opposes this recommendation due to the relatively immature state of market development. We believe the prudent course of action is to establish the wholesale model, give the model sufficient opportunity to produce results that can then be analyzed by the Commission and interested parties.

Moreover, Constellation supports periodic review of the overall competitive procurement process, including the role of the EDC as the POLR Provider, and such deliberation is already provided for in the Chapter 54.183 of the Regulations, pursuant to which an EDC is required to make a filing with the Commission should it desire to terminate its role as the POLR provider. Furthermore, the Constellation Comments proposed a modification to the Regulations add a new Chapter 54.185(n) as follows:

The Commission shall open a docket to review progress in and make any prospective changes in default service regulations at least once every five years. The Commission may require default service providers to establish similar periodic reviews of their individual implementation plans from time to time.⁸

Implementation of this new Regulation proposed by Constellation would ensure that all interested stakeholders have an opportunity to propose modifications to the Regulations that are in the public interest when changing market conditions warrant changes in the fundamental structure of POLR service.

Finally, Dominion Retail Inc. (“Dominion”), while generally supporting the competitive procurement framework embedded in the Regulations, proposes “that the Commission should

⁶ See Comments of Direct Energy Service, LLC, dated April 27, 2005, Docket No.L-00040169, at p. 7 (“Direct Energy Comments”).

⁷ *Id.* at p. 3.

provide incentives for EDCs to be promoters of customer choice.”⁹ Dominion proposes that these incentives should take the form of linking the EDCs role as the default service provider to the amount of switching that has occurred, and that if specific shopping targets are not achieved that EGSs will be given a “first priority to serve the small customer base as the default service provider, over the EDC, under a Commission approved retail auction, if the switching threshold level is not maintained.” Constellation agrees that it is certainly incumbent upon the Commission to monitor market conditions and regularly assess the status of wholesale and retail competition in the Commonwealth, and to assess how the default service design is working to meet the dual goals of (i) promoting retail competition and (ii) providing all customers classes with reasonably priced default service. Dominion appears to propose, however, that the single metric that measures this success is the customer switching statistic. The customer switching statistic, however, is only one of several metrics that should be considered; a much more robust analysis of the markets would require consideration of many other factors, including such factors as (i) the number of retailers and their market concentration, (ii) the diversity of service offerings,(iii) the diversity of competitive retail product offerings, (iv) customer access to supplier and product information and general customer satisfaction with competitive retail service; (v) the overall level of prevailing retail prices when compared to wholesale prices; and (vi) measures of wholesale market liquidity. Constellation believes that the Commission should consider these additional measures as it determines the appropriate next steps in the development of retail competition in Pennsylvania as it is essential that the Commission has an accurate understanding of the retail customers’ understanding of, and satisfaction with, the products and services being offered in the retail market place. Only then can the Commission be assured that Pennsylvania consumers are ready for the next stage in the development of retail competition.

B. Hourly priced service for Large Customers Service should be the presumed default service, unless the EDC files for and get approval of an alternative fixed price service.

In its Initial Comments, Constellation recommended that the Commission adopt the following modification to Chapter 54.187(d) of the regulations:

⁸ Constellation Comments at p. 6.

⁹ See Comments of Dominion Retail, Inc., dated April 27, 2005, Docket No. L-00040169, at p. 9 (“Dominion Comments”).

The default service provider may propose, as an alternative to hourly priced service but not in addition to hourly priced service, a fixed rate for these customers in its default service implementation plan.

Constellation continues to support the presumption that large customers will receive hourly priced default service (“HPS”), but that the EDCs should be allowed to submit implementation plans that propose a fixed price service for its large customers, which would then be subject to review by the Commission, including comments by all interested stakeholders. Constellation, therefore, recommends that the Commission reject proposals by various retail marketers¹⁰ that would require the EDCs to offer only an hourly priced default service for large customers by eliminating the portion of the Regulations that permit the EDCs the flexibility to proposed fixed rate service. Similarly, Constellation also recommends that the Commission reject proposals from various parties¹¹ that would require an EDC to offer *only* a fixed price service to large customers or the option of fixed priced default service or hourly priced default service to its large customers.

Moreover, the Industrial Energy Consumers of Pennsylvania (“IECPA”) recommendations go even further in arguing that the EDCs should be entitled to offer competitive services, rather than simply default service as required by the Act,¹² and further that utilities should provide HPS *and* Fixed Price Service options (“FPS”).¹³ While Constellation appreciates the desires of IECPA’s clients to have access to both fixed price and hourly priced default service, Constellation believes that allowing the EDCs to offer multiple products to the

¹⁰ Direct Energy Comments at pp.13-14; Dominion Comments at p.17; NEMA Comments at p. 7; Comments of Amerada Hess Corporation, dated April 27, 2005, Docket No. L-00040169, at pp. 8-9 (“Hess Comments”); Comments of the Mid-Atlantic Power Supply Association, dated April 27, 2005, Docket No. L-00040169, at pp. 5-6 (“MAPSA Comments”); Comments of Reliant Energy, Inc. on Proposed Rulemaking Order, dated April 27, 2005, Docket No. L-00040169, at p. 7 (“Reliant Comments”); Comments of Strategic Energy, LLC, dated April 27, 2005, Docket No. L-00040169, at pp. 13-18 (“Strategic Comments”).

¹¹ See Comments of Allegheny Conference on Community Development, dated April 26, 2005, Docket No. L-00040169, at p. 2 (“Allegheny Conference Comments”); Comments of Allegheny Power on Proposed Default Service Regulations, dated April 27, 2005, Docket No. M-00041792, at p. 5 (“Allegheny Power Comments”); Comments of Citizens’ Electric Company and Wellsboro Electric Company, dated April 27, 2005, Docket No. L-00040169, at pp. 21-23 (“Citizens’ Comments”); Comments of Duquesne Light Company, dated April 27, 2005, Docket No. L-00040169, at Attachment A, pp. 15-16 (“Duquesne Comments”); Comments of the Industrial Energy Consumers of Pennsylvania, the Met-Ed Industrial Users Group, the Penelec Industrial Customer Alliance, the Philadelphia Area Industrial Energy Users Group, and the PP&L Industrial Customer Alliance, dated April 27, 2005, Docket No. L-00040169, at pp. 5-7 (“IECPA Comments”); Comments of UGI Utilities, Inc. – Electric Division, dated April 27, 2005, Docket No. L-00040169, at pp. 15-16 (“UGI Comments”).

¹² IECPA Comments at p. 1.

¹³ *Id.* at p. 22.

same customers is an appropriate policy for the development of competitive retail markets. In defense of this position, Constellation offers the following response to the arguments of IECPA:

1. IECPA Argument: "because of the impact that increased electricity costs can have on these customers, large commercial and industrial customers are more likely to be detrimentally impacted if DSP regulations do not ensure just and reasonable, and non-discriminatory POLR rates."¹⁴

IECPA's arguments that HPS is not a just and reasonable rate are unfounded. David Magus Boonin of TBS Consulting found that the PJM forward price (the price that forms the basis for wholesale bids for Standard Offer Service, Basic Generation Service and Default Service), particularly in the summer, has a strong upward bias or risk premium – as high as of 100% higher, and that forward prices were 10-15% higher than spot prices overall.¹⁵ Thus, IECPA's arguments lack any merit with regard to the "just and reasonable" standard.

2. IECPA Argument: "[The regulations] are unreasonably discriminatory in that they require a DSP to only offer an HPS option, without requiring at least one fixed price option."¹⁶

In response to this argument, Constellation would first note that the Regulations do not require a DSP to *only* offer an HPS option. Chapter 54.187(d) of the Regulation specifically provide that the EDC may propose a fixed price option. Second, the Regulations specifically provide that the EDCs may offer a default service for small customers that is different than the default service for large customers, but for both classes of customers, the Regulations provide that only one type of default service should be offered to the same customers. If the Commission approved, as IECPA seems to request, multiple default services for large customers, and one default service for non-large customers, this would indeed be discriminatory. In fact, IECPA's request for "*at least one fixed price option*"¹⁷ appears discriminatory relative to other rate classes. In support of their arguments of discrimination, IECPA cites the following

¹⁴ *Id.* at pp. 3-4.

¹⁵ See Comments of TBG Consulting on the Pennsylvania Public Utility Commission's Proposed Rulemaking, dated April 26, 2005, Docket Nos. L-00040169, *et al.*, at p. 1.

¹⁶ IECPA Comments at pp. 5-6.

¹⁷ *Id.* at p. 7.

interpretation of the Restructuring Act: “The Competition Act requires that restructuring be implemented in a manner that does not unreasonably discriminate against one customer class to the benefit of another.”¹⁸ However, this section clearly does not require the Commission to create similar default services for all classes – it only prohibits the Commission from developing a default service for one customer class that would negatively impact the default service in another customer class.

3. *IECPA Argument: “[The HPS] option could subject these customers to arbitrary price increases, market volatility, and potential budgetary constraints.”*¹⁹

First, there is nothing at all arbitrary about HPS service pricing, which will be linked to the PJM spot market prices for energy. To the extent that any of the EDCs implementation plans include HPS for the large customers, and any of those large customers do not want to be subject to spot market volatility, or want to lock in fixed energy prices for budgetary reasons, there are ample opportunities for a large customer to seek a supply product specifically targeted to its operational or budgetary needs from the competitive market. Even IECPA acknowledged this fact in their initial comments by stating, “[a]mong the customer classes, large commercial and industrial customers are most likely to shop because of the significant benefits that can be received from procuring competitive generation.”²⁰

Moreover, with regard to volatility, PPL Electric Utilities Corporation and PPL EnergyPlus, LLC (collectively, “PPL”) accurately argues that implementation of HPS for large customers will ultimately result in less market volatility, in that it will encourage demand side actions in response to volatile hourly prices.²¹ Over time, as demand side response becomes more prevalent, downward pressure on prices should result, and volatility should lessen. Thus, these IECPA arguments in opposition to HPS service are clearly without support.

4. *IECPA argument: “[HPS will force customers] into the competitive market...[where] EGSs will have the opportunity to*

¹⁸ 66 Pa. C.S. 2804 (7).

¹⁹ IECPA Comments at pp. 6-7.

²⁰ *Id.* at p. 3.

²¹ See Comments of PPL Electric Utilities Corporation and PPL EnergyPlus, LLC, dated April 27, 2005, Docket Nos. L-00040169, *et al.*, at p. 12 (“PPL Comments”).

significantly raise their fixed prices above what the market would otherwise bear merely because the market would be the only option for customers seeking fixed price options."²²

IECPA offers no factual evidence to support the notion that large customer markets are not competitive when HPS is the default service. In fact, quite the opposite is true. Markets where HPS is the default service for large customers attract many competitors that keep downward pressure on price and drive competitors to develop more and better product offerings. As evidence of this fact, in Maryland, effective June 1, 2005, HPS is the only default supply service for large customers in the markets behind Baltimore Gas and Electric Company, Potomac Electric Power Company, and Delmarva Power and Light. Currently there are 12 suppliers actively making offers in each of these markets.²³ In New Jersey, HPS is also the only default supply service for certain large customers. There are currently 17 commercial and industrial suppliers currently active in the Connecticut, Public Service Gas & Electric and Jersey Central Power & Light service areas and 5 in the relatively small Rockland Service area. Further, in Texas, where HPS is the default for large customers, there are 30 suppliers actively making offers to these customers whose.

Moreover, if there is evidence to suggest that the retail market is not competitive in a particular jurisdiction, or there are other reasons that large customer should not be exposed to hourly prices, the EDCs or other parties can make those arguments when the EDC files its implementation plan.

5. IECPA argument: "AEPs prohibits the offering of only an hourly priced mechanism for large commercial and industrial customers."²⁴

This is simply not the case. Alternative Energy Credits ("AECs") have been separated from energy – and are not dependent on the hour or day of usage. AECs need only be purchased for the year in aggregate, and can be bought, sold and traded as needed to mesh with annual overall usage for small and large customers, regardless of default service design by the DSP. AEC's are not part of the energy market (with spot or longer term bilateral markets), but are

²² IECPA Comments at p. 24.

²³ See <http://webapp.psc.state.md.us/Intranet/SupplierInfo/searchForCust.cfm>

²⁴ IECPA Comments at p. 25.

separate attributes purchased over the year from AEC sources or AEC brokers. AEPS requirements can be determined by examining overall energy usage from the customer, and AEC purchases, as verified by PJM's Generator Attribute Tracking System. In essence, compliance for a customer taking HPS is no different than if this customer had received a fixed priced product from a DSP or EGS.

In summary, the Commission has established a reasonable threshold of 500 kW as a starting point for HPS service. That is to say, customers with peak loads of 500 kW and above would receive HPS as their default service, unless the EDC proposes and receives approval of an implementation plan that includes fixed price service for these customers. However, consistent with the comments of Direct Energy, Dominion Retail, Reliant Energy and Strategic Energy,²⁵ Constellation also believes that the Regulations should provide flexibility for the Commission to lower the 500 kW threshold for HPS over time as interval metering is expanded, and competitive markets for successively smaller customers become more robust. As was noted above, Constellation has proposed that the Commission should include a recommendation for a specific new regulation 54.185(n) that would permit the kind of review that should be conducted for the purpose of considering these types of changes over time. To reiterate, the recommendation was for a new Chapter 54.185(n) as follows:

The Commission shall open a docket to review progress and make any prospective changes in default service regulations at least once every five years. The Commission may require default service providers to establish similar periodic reviews of their individual implementation plans from time to time.²⁶

C. Obligation for the EDCs to Conduct Competitive Procurement Processes should not be optional.

While most of the Pennsylvania EDCs support the wholesale competitive procurement process envisioned in the Regulations, several of the EDCs and some other parties urge the Commission to broaden the Regulations to allow the utilities to circumvent a competitive procurement altogether and enter into electric supply arrangement to meet their POLR obligations through bilateral negotiations.

²⁵ Direct Energy Comments at p. 14; Dominion Comments at p. 12; Reliant Comments a p. 54; Strategic Comments at pp. 8-9.

²⁶ Constellation Comments at p. 6.

Duquesne Light Company (“Duquesne”), for instance, states that “the Commission’s regulations appear to suggest that the *only* way to procure power for POLR customers is through a wholesale competitive solicitation. Duquesne agrees that a competitive solicitation process is *one* reasonable way to procure power, but that does not mean that it is the *most* reasonable method or that it will be reasonable under *all* market conditions.”²⁷ Duquesne goes on to say that the “proposed regulations needlessly tie the Commission’s hands, however, by equating prevailing market prices with prices realized as a result of a competitive solicitation.”²⁸ Duquesne suggests that alternative forms of procurement may be appropriate in order to stimulate additional retail competition or when the EDC believes that an alternative form will produce more acceptable results. The Allegheny Conference on Community Development, Citizens Electric Company of Lewisburg and Wellsboro Electric Company, Energy Association of Pennsylvania, and UGI Utilities, Inc. - Electric Division also have suggested in their comments that broader discretion should be afforded to the EDCs to file implementation plans that propose procurement processes other than the type of open, transparent competitive procurement process provided for in the Regulations.²⁹

Constellation strongly urges the Commission to reject such recommendations. First, to the extent truly special circumstances may warrant procurement by a utility through some means other than a competitive procurement process, the Chapter 54.188(g) of the Regulations already permits that utility to seek a waiver of the Regulations. The circumstances under which any utility may seek such waiver should be subject to the full scrutiny of a docketed proceeding. Second, and more importantly, the Commission has recognized that customers who do not or cannot choose competitive retail service will see the benefits of competitive markets when their default service provider secures the wholesale energy services necessary to serve their needs in a competitive wholesale procurement process. Duquesne’s arguments that the wholesale competitive process envisioned by the Regulations may not appropriately support retail competition presume, as did Dominion’s proposal, that switching statistics are the sole measure for determining the success of a competitive procurement process. As these Constellation Reply Comments discussed above, there are other, equally important metrics that must be considered.

²⁷ Duquesne Comments at p. 5.

²⁸ *Id.* at p. 7.

Finally, as most of the Pennsylvania utilities that will provide default service have unregulated affiliates, a well designed, open and transparent competitive procurement process will ensure that there is no preferential advantage conferred on the affiliates when the utility contracts for the wholesale energy services that its needs to meet its POLR obligations.

D. Minimum stay requirements and exit fees must not be implemented.

Many of the utilities in their comments seek to expand their rights to impose switching restrictions or exit fees in one form or another on default service customers who avail themselves of competitive opportunities.³⁰ EAPA's comments provide a good review of the typical rationales offered for imposing switching fees.

First, EAPA argues that default service providers cannot effectively manage the supply risk associated with customer migrations.³¹ EAPA fails to understand that it is not the EDC that manages or bears the migration risk of customers that opt into or out of competitive supply service. Instead, it is wholesale default service suppliers who manage this risk. For example, in New Jersey and Maryland, respectively, the wholesale suppliers of Basic Generation Service ("BGS") and Standard Offer Service ("SOS") absorbs this migration risk, and do so without switching restrictions or exit fees. The Regulations, in Chapter 54.187(g) appropriately provide for EDCs to include in their implementation plans specific mechanisms to adjust rates due to customer migration.

Secondly, EAPA encourages this Commission to impose switching restrictions by arguing that the price of default service will be higher if fewer restrictions are placed on customer migration.³² It is true that customer attrition is a risk that must be factored into the bid price from wholesale suppliers, the larger issue is if this risk can be reasonably managed, and not result in unreasonable default service prices. The evidence in this situation is clear. Migration risk can be reasonably managed without imposing switching restrictions and exit fees. It can be inferred from the Office of Small Business Administration's ("OSBA") comments that it does

²⁹ Allegheny Conference Comments at p. 3; Citizens' Comments at p. 12; Comments of the Energy Association of Pennsylvania on Proposed Default Service Regulations, dated April 27, 2005, Docket No. L-00040169, at pp. 3-5 ("EAPA Comments"); UGI Comments at pp. 8-9.

³⁰ See Comments of the Exelon Companies to the December 16, 2004 Proposed Rulemaking Order, dated April 27, 2005, Docket No. L-00040169, at p. 19 ("Exelon Comments"); Duquesne Comments at pp. 23-24; EAPA Comments at pp. 3, 10; PPL Comments at p. 17; UGI Comments at pp. 14-15.

³¹ EAPA Comments at p. 10.

³² *Id.* at p. 10.

not view the migration risk of its clients to be significant if separately bid.³³ The Office of the Consumer Advocate (“OCA”) believes that migration risk of residential customers can be reasonably managed through a mix of long and short term suppliers.³⁴ Lastly, large customer migration risk is largely mitigated through the Commission’s expressed preference for hourly priced default service, which, by its very nature cannot be “gamed.” To the extent that the Commission approves a fixed price service for large customers in any of the EDC jurisdictions, the Commission can alleviate gaming concerns by other market based mechanism, such as shorter term pricing strategies that other jurisdiction have adopted, or other volumetric risk mechanism such as those employed in Maryland.³⁵

Third, some parties argued that since seasonal gaming occurred during the transition period, it could occur after the transition period.³⁶ If the Commission does not adopt appropriate default service pricing to address seasonal gaming, it is true that gaming might occur again. However, Section 54.187(g) of the Regulations has appropriately recognized the importance of seasonal pricing and proposed additional regulations to allow wholesale suppliers and DSPs to reasonably mitigate any large migration of customers back to default service. This regulation should permit the DSP to adopt the volumetric risk mitigation methodology referenced above and more fully described by Strategic Energy³⁷ as well as previously described by Constellation.³⁸

Lastly, EAPA recommends that customers returning to default service should be placed on a two month market based price while deciding on whether or not to return to default service.³⁹ As the Commission is aware, Pennsylvania Electric Company and Metropolitan Edison Company recently filed a complex array of four different options to require customers to pay market rates (or sometimes the higher of market rates or regulated rates) during the transition period in order for a customer to avail themselves of competitive alternatives at any time.⁴⁰ With

³³ See Comments on Behalf of the Office of Small Business Advocate on the Proposed Rulemaking, dated April 27, 2005, Docket No. L-00040169, at p. 16 (“OSBA Comments”).

³⁴ See Comment of the Office of Consumer Advocate, dated April 27 2005, Docket Nos. L-00040169, *et al.*, at pp. 47-48 (“OCA Comments”).

³⁵ See Response of Constellation Power Source, Inc. and Constellation NewEnergy, Inc. to the POLR Roundtable Issues List, dated June 14, 2004, Docket No. M-00041792, at pp. 17-18.

³⁶ PPL Comments at p. 17; UGI Comments at pp. 14-15.

³⁷ Strategic Comments at p. 18.

³⁸ See Footnote No. 35, *supra*.

³⁹ EAPA Comments at p. 10.

⁴⁰ See Amended Joint Petition for Full Settlement of Generation Rate Adjustment, dated May 27, 2005, Docket Nos. R-00016219, *et al.*

regard to these arrangements, Constellation agrees with the references of the IECPA in this proceeding that “many customers may be hesitant to enter the competitive market unless adequate assurances are in place, which ensure that upon return from the market, these customers will receive just, reasonable, and non-discriminatory POLR rates.”⁴¹ The denial of access to the same default service by customers that avail themselves of competitive market opportunities should be avoided at all costs, in favor of one basic default service for each customer class, consistent with Section 54.189 (b) and (c) of the proposed regulations.

In its comments, OSBA suggested that EDC’s should consider prohibiting an EGS from entering into contracts with customers that terminate within one month of the beginning of the EDC’s peak season.⁴² Such a suggestion is entirely unworkable. The Commission has proposed to align the start of any default service season with the start of the PJM planning period, which is also the start of the peak summer season. It is likely that a majority of contract effective dates and termination dates will at least initially coincide with the start of the peak season under any annual fixed rate proposal. OSBA’s proposal represents another form of customer switching restrictions which are always harmful to retail competition, and which become unnecessary when other mechanisms, such as seasonal prices and other market based volumetric risk mitigation measures, are implemented.

Increased levels of migration means that consumers have opportunities in the market place to select their own retail electric provider. How the Commission assigns risk to an increasing level of migration, will determine whether retail choice continues to grow, or retracts. Constellation encourages the Commission to adopt policies that rely on market solutions (seasonal pricing, volumetric risk mitigation), and not administratively determined market restrictions (minimum stays, alternative default service pricing for shopping customers, and [GRA] exit fees). To that end, Constellation endorses the comments of Amerada Hess Corporation (“Hess”),⁴³ and recommends that the Commission firmly confirm its commitment to the Competition Act by declining to adopt non-market based minimum stays or exit fees. Lastly, Constellation agrees with Strategic that the list of reasons provided under Section 54.123(a) of

⁴¹ IECPA Comments at p. 3.

⁴² OSBA Comments at p. 16.

⁴³ Hess Comments at p. 12.

the proposed regulations should not be treated as exhaustive, since there are, as documented by Strategic, other legitimate reasons for termination of supply service by an EGS.⁴⁴

E. Seasonal Rates should be included in the implementation plans

As noted above, seasonal rates are an important deterrent to potential “gaming.” However, Constellation also agrees with OCA and OSBA that seasonal rates should not be adopted merely because they thwart potential inappropriate behavior by EGSs or simply to make default service rates “ugly,”⁴⁵ but because these rates are supported on their own merit.

Seasonal rates ensure that customers that avoid energy usage during peak seasons don’t subsidize customers that take no actions to avoid peak usage. For the same good and valid reasons that OSBA supports rate class by rate class bidding to remove inappropriate generation related embedded subsidies,⁴⁶ it would be equally inappropriate to ask off-peak season energy users to subsidize on-peak season energy users. In the end, sending the proper price incentives will provide further economic support for cost effective Demand Side Management programs and Energy Efficiency investments that reduce overall energy costs. These steps need not make customers uncomfortable, or impinge on operations and business, a concern that OSBA has expressed.⁴⁷ Instead, proper price signals will provide incentives to consumers to, for example, install more efficient AC units, improve insulation, invest in energy reducing lighting fixtures and controls, and install more efficient computer and manufacturing systems. Moreover, while it is difficult to assess how customers in Pennsylvania will react, since they have had little exposure to real market pricing, it is fair to predict that the results will be consistent with other jurisdictions. For example, at the June 21, 2005 National Town Meeting on Demand Response, (sponsored by the FERC, DOE, EPA and the Demand Response Coordinating Committee) several studies were cited in support of the proposition that consumers of all sizes and, among residential customers, of all income levels, respond to price signals.

Finally, seasonal pricing is not “ugly,” nor is it punitive as suggested by OSBA.⁴⁸ Seasonal pricing has already been adopted by all major investor owned utilities in Maryland (as part of the SOS proceedings), Delaware (already implemented during the transition period), the

⁴⁴ Strategic Comments at p. 20.

⁴⁵ OCA Comments at p. 22; OSBA Comments at pp. 16-17.

⁴⁶ OSBA Comments at p. 11.

⁴⁷ *Id.* at p. 17.

District of Columbia (both during the transition period and post-transition period), New Jersey (post transition period) throughout most of Virginia in the Dominion Virginia Power service territory (transition period), and even in the PECO service territory in the Commonwealth (transition period). The advantages of such having seasonal price signals are clear, as noted above, and consumers have adapted well to such pricing mechanisms. Constellation, however, is sensitive to the concerns of the impact on low income consumers and believes that balanced billing services can be designed with these specific needs in mind.

In short – seasonal pricing is a well tested and extensively implemented element of rate design in the Mid-Atlantic Region, and there is ample reason for Pennsylvania to move to this more market based approach for default service.

F. Statewide standardization of Competitive Bid Processes is Not Necessary At This Time.

While standardization across all the Pennsylvania jurisdictions competitive procurement process design and features, including length of contract terms, forms of auction, etc., may provide some benefit in terms of reducing complexities and thus enhancing wholesale and retail competition, those benefits are far outweighed by the need for the Commission, utilities and stakeholders to carefully review the specific circumstances applicable in each service territory when developing a competitive procurement process. Moreover, to the extent that the Commission or the EDCs find that there are specific and compelling efficiencies to be gained by combining their competitive procurement processes, Chapter 54.185(e) already permits this. Thus, Constellation believes that the benefits of statewide standardization or standardization among several EDCs should continue to be evaluated and implemented, where there is general agreement that such standardization would be beneficial.

G. Flexibility to offer fixed price terms less than 1 year

Constellation concurs with Hess that the Commission should amend Section 54.185(c) to grant the flexibility for the Commission to approve fixed price periods that are less than 1 year.⁴⁹

⁴⁸ OSBA Comments at pp.16-17.

⁴⁹ Hess Comments at p. 11.

Sub-annual pricing periods have been used effectively in Maine⁵⁰ and Massachusetts⁵¹ for medium and large customers. The intent of Section 54.185(c) is unclear. For example, a default service program could be approved for 1 year, yet require multiple bid periods throughout the year, as is the case in Maine and Massachusetts. The Commission should clarify that Section 54.185 would not preclude a default service plan for certain customer segments that would be bid out more than once per year.

H. Collection of all costs for HPS service

Constellation agrees with the comments of Duquesne, that HPS should include both a customer charge and renewable charge.⁵² Accordingly, Constellation agrees with the proposed clarifications made by Duquesne to Section 54.187.

I. All costs related to default retail supply service should be included in the default service rates.

Several EDC's argued that the Commission should continue to include all retail service costs in the distribution rates. Allegheny Power specifically claimed that "it is premature to consider which, if any services traditionally provided by the EDC can or should be provided by the EGS."⁵³ On the contrary, it is essential that subsidies for default service be removed if the regulations are going to meet the dual goals of promoting retail competition while providing reasonably priced service to default service customers. Just because a cost was (improperly) included in the distribution rates prior to restructuring does not mean the Commission should be precluded from removing this subsidy going forward. Moreover, EGSs are already providing all of the services listed by Allegheny Power other than metering. Duquesne's allegations that EGSs do not provide billing services are clearly false.⁵⁴ All EGSs must render timely bills in order to provide supply service.

⁵⁰ See *Order Designating Standard Offer Providers*, dated January 21, 2004, Maine PUC Docket No. 2003-823, at p. 3.

⁵¹ See *Investigation by the Department of Telecommunications and Energy on its own Motion into the Provision of Default Service*, Docket No. D.T.E. 02-40-c, at p. 22.

⁵² Duquesne Comments at p. 25.

⁵³ Allegheny Power Comments at p. 8.

⁵⁴ Duquesne Comments at p. 27.

Others argued that further unbundling would be too complex, costly and difficult to separate out.⁵⁵ EAPA similarly argued that these retail services are not provided separately, and therefore all costs should remain in the distribution rates.⁵⁶ Difficulty is no excuse. Rate making has always been a complex process, and this addition to the regulations is no exception. Other jurisdictions have successfully dealt with these administrative service charges, and Pennsylvania should be no exception.⁵⁷ As noted by NEMA, “Proper rate unbundling is a prerequisite to sending proper price signals to educate consumption decisions and permit suppliers to invest risk capital to make competitive product and service offerings available to Pennsylvania consumers.”⁵⁸ The effort to better reflect the full cost of retail service costs in the default rate will pay big dividends going forward, since more equitable allocation of costs will spur competition for these services. Competition will lead to innovation in customer services and improved service. Constellation recommends that such costs must be unbundled in a Cost of Service proceeding, or estimated on an interim basis, as suggested by Strategic Energy.⁵⁹

Duquesne attempts to discredit the idea of a customer charge simply because their billing requirements are different than that of an EGS.⁶⁰ This point is irrelevant to the need to include their true cost of service in the default service rate. Further, while EGSs can return customers to default service for failure to pay for service, it is equally true that EGSs have very little ability to enforce payment, because they cannot terminate electricity service – only the utility can and only for failure to pay utility charges. Duquesne’s arguments fail to mention this important restriction on the ability of an EGS to enforce customer payment (and therefore incur potentially higher bad debt expense).

Yet other EDCs argue that full unbundling might threaten the integrity of the metering, billing and customer service processes.⁶¹ Since the EDCs are entitled to collection of all default service costs by the Competition Act,⁶² this argument is baseless. What is at risk is the utility’s

⁵⁵ See Comments of Pike County Light & Power Company, dated April 25, 2005, Docket No. L-00040169, at p. 4 (“Pike County Comments”); Comments of GPU, dated April 27, 2005, Docket No. L-00040169, at p. 6 (“GPU Comments”); Duquesne Comments at p. 27; UGI Comments at p. 10.

⁵⁶ EAPA Comments at p. 8.

⁵⁷ See Settlement Agreement, dated November 14, 2005, Maryland PSC Case No. 8908, at PP 12, 31, 50, 68, and 82; Order No. 13268, issued August 19, 2004, District of Columbia PSC Formal Case No. 1017.

⁵⁸ NEMA Comments at p. 2.

⁵⁹ Strategic Comments at p. 23.

⁶⁰ Duquesne Comments at p. 27.

⁶¹ *Id.* at p. 30.

⁶² See Section 2807(e)(3) of the Public Utility Code.

existing subsidy – and thus the attractiveness of POLR service in comparison to that of competitive suppliers.

EAPA and UGI claim that such further unbundling is inconsistent with the Competition Act, since the Act provides for unbundling to take place during the restructuring proceedings.⁶³ It is noteworthy that EAPA failed to offer any cite in support of this interpretation of the Act. A review of Section 2804 (3) that deals with unbundling establishes no time frame for this unbundling. Section 2804 simply cites “restructuring” as the relevant timeframe. As is apparent in this docket, restructuring of the electricity industry is an ongoing process in Pennsylvania. If anything, the Competition Act provides the flexibility for the Commission to order unbundling of other services.⁶⁴ Thus, EAPA’s reference to the Act actually reinforces the Commission’s authority to further unbundle retail supply services, the costs of which are currently embedded in the distribution rate.

EAPA further seeks to dissuade the Commission from its customer charge policy by arguing that cost separation would probably not occur on a revenue neutral basis.⁶⁵ However, given the uncertainty in demand, there is never perfect revenue neutrality in any rate making process. Distribution rates are calculated based on test period costs, and projected forward. Each year, a utility over-collects or under-collects based on actual throughput on the system and actual costs. If a utility consistently over-collects or under-collects, the utility or another party can petition for a rate case to revise the rates. Revenue neutrality is a lofty goal that is rarely met. Secondly, the Commission should adopt regulations that would permit use of the crediting mechanism⁶⁶ approved by the Maryland Public Service Commission in Case No. 8908, and further adopted by the District of Columbia in Formal Case No. 1017 if it truly wants to ensure revenue neutrality and avoid over-or under collection, given the current scenario of incomplete unbundling. This reconciliation mechanism would avoid the complications associated with utility collection of default service costs given a potential shift in the number of default service customers noted by PPL.⁶⁷

⁶³ EAPA Comments at p. 8; UGI Comments at p. 11.

⁶⁴ Section 2804(3) of the Public Utility Code states, “The Commission may require unbundling of other services.”

⁶⁵ EAPA Comments at p. 8.

⁶⁶ Strategic Comments at pp. 23-24.

⁶⁷ PPL Comments at pp. 9-10.

Others parties argue that only incremental costs should be allocated to default service.⁶⁸ This proposal is self serving and without merit. Duquesne admits that incremental costs are negligible, whereas all retail service costs, such as billing costs, are substantial.⁶⁹

In an final attempt to support its proposal to keep costs in the distribution rates, EAPA and GPU argue that since the EDC will remain as the DSP for the foreseeable future, it is logical that the retail default service costs should remain in the distribution rate.⁷⁰ The circular logic of this argument is not difficult to refute. The failure to create equity in the competitive supply arena will discourage competition from fully developing in the Commonwealth of Pennsylvania.

Constellation is sensitive to the concerns of IECPA and OCA that retail supply service unbundling should ensure that the utility does not result in “double dipping” by the DSP/EDC, or require the customer to pay twice for the same service.⁷¹ To address these concerns, the Commission should fully allocate these costs between distribution and supply service, or develop a crediting mechanism that ensures that the EDC does not retain revenues twice for the same service. By the same token, as noted by NEMA, if a migrating customer is paying to receive these services (such as billing, customer care, etc.) from a competitive supplier, it should not have to continue to pay the utility for these services.⁷² In short, neither shopping customers nor default supply service customers should be required to pay for retail supply services twice.

J. Bundling customer charges into one charge will simplify consumer shopping decisions.

Many parties suggested that the customer charge component should be bundled into the Generation supply charge or Price to Compare.⁷³ Constellation believes that the bundling of the charges (generation supply charges, transmission charges, customer charges and AEPS compliance charges) in the retail tariff is a good suggestion that would simplify consumer shopping decisions. However, this should not remove the obligation for the DSP to clearly show the magnitude of each of these components in the default service compliance filings to maintain the transparency of these costs.

⁶⁸ Allegheny Power Comments at p. 9.

⁶⁹ Duquesne Comments at pp. 29-30.

⁷⁰ EAPA Comments at p. 9; GPU Comments at p. 6.

⁷¹ IECPA Comments at p. 6; OCA Comments at p. 19.

⁷² NEMA Comments at p. 9.

K. True-up adjustments to default supply rates, if allowed, should be made on a frequent basis.

Many EDCs and the OCA recommended that supply rates should be adjustable.⁷⁴ The argument was often based on the statutory requirement that DSPs are entitled to full recovery of default service supply costs,⁷⁵ and that the reconciliation of the generation supply charge would be consistent with the adjustment mechanism if allowed under the Alternative Energy Portfolio Standard, (AEPS) Act, No. 213 of 2004.⁷⁶ The EDC's further argued that the adjustments were needed in order to allow for the return of a large number of customers to default service,⁷⁷ changes in reliability mechanisms or PJM rules,⁷⁸ default of a wholesale supplier,⁷⁹ extraordinary circumstances.⁸⁰ Constellation notes that a truly fixed price would simplify shopping decisions for less sophisticated small customers. However, if the Commission permits utilities to make adjustments, Constellation recommends that the following requirements be met: (1) such changes in price will not be unduly delayed – in order that appropriate price signals are sent⁸¹ and that future default service customers don't subsidize current default service customers; and (2) customers are informed and educated that the default service is not a fixed priced service, and that the price can change for a number of reasons - and list those circumstances. GPU's suggested quarterly adjustment mechanism⁸² would likely be sufficient to keep the utility's price reasonably close to market.

L. The Commission should not limit utilities as the only entities that will provide Demand Side Response Programs.

Constellation concurs with the comments of OSBA that Demand Side Response (“DSR”) programs by the DSP should not be mandated.⁸³ OSBA correctly argues that DSR programs are

⁷³ See Comments of Richards Energy Group, Inc., dated April 26, 2005, Docket Nos. L-00040169, *et al.*, at p. 1; Dominion Comments at p. 8; Exelon Comments at p. 5; GPU Comments at p. 6; OCA Comments at p. 19.

⁷⁴ Exelon Comments at pp. 5, 17, 18; GPU Comments at p. 2; UGI Comments at p. 13.

⁷⁵ See Section 2807(e)(3) of the Public Utility Code.

⁷⁶ Exelon Comments at p. 5; OCA Comments at p. 5, PPL Comments at p. 8.

⁷⁷ Allegheny Power Comments at p. 11; Duquesne Comments at p. 35; EAPA Comments at p. 7; GPU Comments at p. 3; UGI Comments at p. 13.

⁷⁸ Allegheny Comments at p. 10; Duquesne Comments at p. 36.

⁷⁹ Allegheny Comments at p. 10; Duquesne Comments at p. 35, GPU Comments at p. 4.

⁸⁰ Allegheny Comments at p. 11.

⁸¹ GPU Comments at p. 3.

⁸² *Id.* at p. 4.

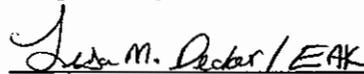
⁸³ OSBA Comments at p. 14.

but one means of meeting the AEPS requirements. Mandatory DSR programs by a DSP may also have the unintended consequence of stifling competitive market DSR programs that are currently available and administered by PJM, and offered by Curtailment Service Providers. To that end, Constellation takes issue with PJM's comments that would appear to limit DSR programs related to default service supply solely to the utility. While Constellation agrees with PJM that the energy related to a customer's DSR program should accrue to the end-user or the end-user's designee, the utility should not be designated as the sole interface for the customer with regard to DSR programs. More specifically, a link is not necessary between the DSP and the end-user.⁸⁴ What is more important is that the end-user is able to avail themselves of wholesale rules that entitle that end-user or their designee to the benefits of DSR. The issues that PJM raises in its comments are beyond the scope of this Rulemaking.

III. CONCLUSION

Constellation again commends the Commission for issuing a set of well designed Default Service Regulations. Constellation looks forward to continuing to work closely with the Commission and other stakeholders to ensure that the implementation of the Regulations brings the benefits of competitive markets to consumers.

Respectfully Submitted,



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⁸⁴ See Comments of PJM Interconnection, dated April 27, 2005, Docket No. L-00040169, at p. 7.